Keysight Technologies Fourth Quarter 2024 Earnings Conference Call

Prepared Remarks

PAULENIER SIMS

Thank you, and welcome everyone to Keysight's Fourth Quarter Earnings Conference Call for Fiscal Year 2024.

Joining me are Keysight's President and CEO, Satish Dhanasekaran, and our CFO, Neil Dougherty. In the Q&A session we will be joined by Chief Customer Officer, Mark Wallace.

The press release and information to supplement today's discussion are on our website at investor.keysight.com under financial information and quarterly reports. Today's comments will refer to non-GAAP financial measures. We will also make reference to "core" growth, which excludes the impact of currency movements and acquisitions or divestitures completed within the last twelve months. The most directly comparable GAAP financial metrics and reconciliations are on our website, and all comparisons are on a year-over-year basis unless otherwise noted.

We will make forward-looking statements about the financial performance of the company on today's call. These statements are subject to risks and uncertainties and are only valid as of today. We assume no obligation to update them and encourage you to review our recent SEC filings for a more complete view of these risks and other factors.

Lastly, management is scheduled to participate in upcoming investor conferences hosted by Wells Fargo and Barclays.

And now I will turn the call over to Satish.

SATISH DHANASEKARAN

Good afternoon, everyone, and thank you for joining us today.

My comments will focus on three key headlines.

- First, Keysight executed well and delivered fourth quarter revenue and earnings per share above the high end of our guidance range under market conditions which remained consistent with our expectations. Orders finished slightly above our expectations and grew 1 percent year-over-year and 8 percent sequentially, driven by ongoing strength in AI and strong year-end bookings in our US aerospace, defense and government business.

- Second, strong execution and cost discipline drove full-year revenue of $5 billion and earnings per share of 6 dollars and 27 cents, which were down from the record highs of 2023. Results were paced by a gradual improvement throughout the year with better performance in the second half, as expected. Under challenging market conditions, we demonstrated the resilience of our business model by delivering 26% operating profit and over $900m in free cash flow. We also returned approximately fifty percent of free cash flow to shareholders through repurchases.

- Third, we progressed our software-centric solutions strategy by investing to realize organic growth opportunities through innovation and industry collaborations while expanding the breadth of our solutions through selective M&A. As we look ahead, the strength of our differentiated portfolio, deep engagement with customers, and the accelerating pace of technology innovation give us confidence in our ability to outperform as markets recover.

Now, let's begin with an overview of Keysight's fourth quarter business performance…

Communications Solutions Group revenue was flat year-over-year and grew 6 percent sequentially with growth across both commercial communications and aerospace, defense, and government. CSG orders returned to growth for the full year, reflecting AI momentum in wireline, stability in wireless, and consistent strength in ADG.

In wireline markets, demand remains strong due to ongoing expansion in AI data center infrastructure, even as telco investments continue to be muted. As the timeline for 800 gig and 1.6 terabit adoption accelerates, the industry is investing in advanced technologies, including silicon photonics, chiplets, and high-speed electrical and optical interconnects. Keysight continued to expand its portfolio of solutions across the technology stack to enable customers in both R&D and manufacturing. At the Open Compute Project in San Jose, Keysight showcased our newly introduced AI Workload and System Emulation solution in collaboration with academia and hyperscalers. Our solution provides high-fidelity emulation of AI Model Training and Inferencing workloads to optimize training time and benchmark AI Infrastructure performance. At the ECOC conference, Keysight showcased physical and protocol-layer solutions with industry leaders, to enable 800 gig interoperability with critical optical and electrical interface technologies.

In wireless, demand was stable, as the smartphone industry nears the end of its inventory correction and telco capex normalizes from peak levels. Investment continues in Open RAN expansion, ongoing standards progression with emphasis on non-terrestrial-networks, and early 6G research. This quarter we announced multiple O-RAN collaborations with industry leaders such as NTT Docomo, Dish Networks and Pegatron. We also collaborated with Qualcomm to establish the industry's first end-to-end interoperability and data connection in the candidate frequency band for 6G, FR3. We are well-poised to drive industry innovation forward with our differentiated, full-stack solutions.
Turning to aerospace, defense, and government, stronger than expected seasonality drove orders to an all-time high. The funnel of opportunities remains strong. The U.S. defense budget is expected to grow low-single digits, while government investment in defense modernization in Europe and Asia is projected to increase. Customer engagement on electromagnetic spectrum operations, radar, and advanced communication use cases remains high. Satellite communications investment is expected to continue as more LEO constellations are launched over the next few years. Keysight is capitalizing on growing investment in defense modernization around the globe. At the recent European Microwave conference, we showcased our leading capabilities in phased-array, over-the-air, compact antenna design and test in collaboration with Analog Devices. We also highlighted our latest flagship performance network analyzer. Its differentiated and industry-leading capabilities include wideband, high-dynamic range, pre-selected receivers for faster S-parameter measurements, to enable customers' high-frequency component designs.

Turning to the Electronic Industrial Solutions Group, revenue was down year-over-year as expected, but grew mid-single digits sequentially. Orders were mixed, with year-over-year growth in semiconductor and general electronics offset by automotive market headwinds.

In semiconductor, robust demand drove strong order growth for our parametric wafer test solutions. We saw broad-based foundry investment to expand capacity and address leading-edge applications driven by AI. This included advanced DRAM technologies, such as high-bandwidth memory and DDR5, as well as silicon photonics. Enabling further advances in power semiconductor production and efficiency, this quarter Keysight introduced an innovative single-pass 3 kilovolt high-voltage wafer test solution.

In automotive, the industry is facing challenges, and we expect headwinds to continue in 2025. This quarter, production-related demand was sequentially stable, while we saw incrementally cautious spending due to slowing EV sales and battery oversupply. Even with near term headwinds, we remain focused on customers' emerging innovation and design needs. Our R&D engagements for software-defined vehicle, as well as broader electrical and physical design applications, remain high. ESI grew its solutions business this year through steady renewals and new customer additions. Over this period, the ESI team made significant contributions through the use of AI to improve product performance simulations, and offering workflow solutions with immersive visualization to validate assembly and servicing.

In general electronics, we saw stable manufacturing demand, albeit at lower levels, and a modest sequential improvement in consumer and industrial high-speed connectivity applications. Public and private sector investment in support of advanced research and technology workforce development grew this quarter, and digital health application demand was again strong.

Turning to software and services, revenues grew 8 percent this quarter and accounted for 39 percent of total Keysight revenue. Annual recurring revenue from software and services also grew 16 percent to approximately $1.5 billion and accounted for roughly 30 percent of Keysight overall. We saw solid growth in our Design Engineering Software portfolio in FY24, reflecting the expansion of virtual prototyping across a broad range of industries. As a recognized thought leader in RF EDA, Keysight was selected to lead a U.S. government joint public and private sector effort to leverage AI and Machine Learning to automate and bring efficiencies to complex RF integrated circuit design.

In summary, Keysight has continued to sustain strategic progress and momentum through the downturn. The flexibility and discipline of our operating model has proven our ability to deliver strong financial results and healthy cash flows in a variety of economic conditions. We have positioned the business to emerge stronger as markets recover, to capitalize on the opportunities ahead of us, and to create value for all our stakeholders.

Before I conclude, I'd like to sincerely thank our employees once again for their outstanding contributions, commitment, and strong track record of execution under a variety of market conditions.

With that, I will turn it over to Neil to discuss our financial performance and outlook.

NEIL DOUGHERTY

Thank you, Satish, and hello, everyone. Fourth quarter revenue of $1 billion 287 million was above the high end of our guidance range and down 2 percent, or down 5 percent on a core basis. Orders of $1 billion 345 million were up 1 percent as reported, or down 1 percent on a core basis. Backlog increased $53 million in the quarter to finish at $2.4 billion.

Looking at our operational results for Q4, we reported gross margin of 64.5 percent. Operating expenses of $497 million were up 5 percent year-over-year. Q4 operating margin was 26 percent, or 28 percent on a core basis.

Turning to earnings, we achieved $288 million of net income and delivered earnings per share of 1 dollar 65 cents. Our weighted average share count for the quarter was 174 million shares.

For the full-year, Keysight generated revenue of $4 billion 979 million, down 9 percent as reported, or down 12 percent on a core basis. Gross margin was 65 percent, down 60 basis points versus the prior year. We sustained investment in R&D at $871 million, or 17.5 percent of revenue, while driving further operating efficiencies in SG&A, which declined 7 percent excluding acquisitions. Full-year core operating margin of 26.5% was down 370 basis points, continuing to outperform Keysight's downcycle model and demonstrating the financial resilience of the business. Net income of $1.1 billion resulted in earnings per share of 6 dollars 27 cents.

Moving to the performance of our segments, the Communications Solutions Group generated fourth quarter revenue of $894 million, flat as reported or down 2 percent on a core basis. Commercial communications revenue of $591 million grew 4 percent, while aerospace, defense, and government revenue of $303 million declined 6 percent. Altogether, CSG delivered gross margin of 67 percent, and operating margin of 28 percent. The Electronic Industrial Solutions Group generated revenue of $393 million, down 6 percent, or 11 percent on a core basis. EISG reported gross margin of 58 percent, and operating margin of 21 percent, an increase of approximately 100 basis points versus the prior quarter.

Moving to the balance sheet and cash flow, we ended the quarter with $1.8 billion in cash and cash equivalents, generating cash flow from operations of $359 million, and free cash flow of $328 million. Share repurchases this quarter totaled 974 thousand shares, at an average price per share of approximately $154, for a total consideration of $150 million. Full-year share repurchases totaled $439 million, or 49% of the $905 million in free cash flow generated this year.

Now, turning to our outlook…

We expect the demand environment to remain mixed, and for recovery to occur gradually through the year barring any further macro degradation. Our base case assumptions for FY25 are for revenue growth at the low end of our 5 to 7 percent long-term target, and earnings growth in line with our 10 percent target.

As a reminder, the timing of ESI's annual contract renewals typically results in 40-45% of their full-year revenue being recognized in our fiscal first quarter, with the balance recognized relatively evenly over the remainder of the fiscal year. For the rest of the business, we are modeling the typical mid-single digit seasonal decline in revenue from Q4 to Q1.

As a result, we expect first quarter revenue to be in the range of $1 billion 265 million to $1 billion 285 million, and Q1 earnings per share in the range of $1.65 to $1.71, based on a weighted diluted share count of approximately 174 million shares.

Now, a few modeling considerations for the full year. Given the annual ESI contract renewals in Q1, we expect a material sequential decrease in ESI revenue in Q2, and over the same period we expect a low single-digit increase in core Keysight revenue. At current debt levels, annual interest expense is expected to be approximately $70 million, capital expenditures are expected to be approximately $150 million, and we are modeling a 14 percent non-GAAP effective tax rate for FY25.

With that, I will turn it back to Paulenier for the Q&A.